Supreme Court, U.S.
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No. 14-163

IN THE

Supreme Court of the United States

BANK OF AMERICA, N.A.,

Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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As Bank of America explained in its reply in support of certiorari in *Bank of America, N.A.* v. *Caulkett*, No. 13-1421, the decision below—holding that a chapter 7 debtor may strip off a valid junior lien on the debtor's house merely because the lien is wholly underwater—splits with every other court of appeals that has decided the question.[1] The Eleventh Circuit acknowledged it. Pet. App. 13a. And respondent admits it. Opp. 9. In the Fourth, Sixth, and Seventh Circuits such a lien cannot be stripped off; in the Eleventh Circuit it can be.

Respondent's efforts to minimize the split (at 8-10) fail. A 3-1 circuit split is not insignificant. Respondent's assertion (at 9) that the courts of appeals have not taken account of one another's opinions is incorrect. Nor is it relevant that two of the four circuits considered the question "before the financial-crisis spike in bankruptcy filings" (*id.*), unless one believes that the meaning of the Bankruptcy Code changes when the number of bankruptcy filings increases. And respondent's claim (at 8, 9) that the lien-stripping issue is "rare[]" and "not ... important" is just wrong. This issue arises daily in bankruptcy courts across the country, and Bank of America—just one servicer—has 65 lien-stripping matters pending in the Eleventh Circuit alone. *See* Pet. 18-20. Indeed, this question may be the single most important unresolved issue in consumer bankruptcy, affecting every debtor or potential debtor

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[1] The petition in *Caulkett* is identical in substance to this one (*see* Pet. 3-4), and because the debtors in both cases are represented by the same counsel, the briefs in opposition are also materially identical.

Bank of America respectfully submits that the petition in *Caulkett* should be granted and this petition held pending *Caulkett*'s disposition. In the alternative, the Court should grant this petition.

with a second mortgage and every lender who made such a loan.

Respondent's attempts to manufacture a vehicle problem also fail. All the relevant facts in this case are undisputed; the undeveloped facts respondent points to (at 20) are irrelevant—and in any case it would have been respondent's burden, as the movant, to develop them. And the Eleventh Circuit has considered the question as fully as it ever will. When this Court denied certiorari in *Bank of America, N.A.* v. *Sinkfield*, No. 13-700, there was still a possibility that the Eleventh Circuit would rehear the issue en banc. Since then, the Eleventh Circuit has denied three petitions for rehearing en banc of this issue, making clear that its decision in *McNeal* v. *GMAC Mortgage, LLC*, 735 F.3d 1263 (11th Cir. 2012), is the court's last word on the subject. Certiorari was not sought in *McNeal* itself, so this case, in which the Eleventh Circuit relied on *McNeal*, is the perfect opportunity for this Court to review the issue.

Respondent's primary argument against granting certiorari is that the Eleventh Circuit's decision is correct. If true, that would be a powerful argument for *granting* certiorari, since on respondent's theory, three courts of appeals and lower courts across the country have wrongly decided this issue. Even the Eleventh Circuit, however, recognized that this Court's decision in *Dewsnup* v. *Timm*, 502 U.S. 410 (1992), "seems to reject" its reasoning. Pet. App. 14a. Indeed it does. Respondent's contrary contentions misapprehend *Dewsnup*, the Bankruptcy Code, and basic principles of statutory interpretation. But whichever side is correct on the merits, this division of authority on a critically important question must be resolved and should be resolved now.

I. Only This Court Can Resolve The Square And Acknowledged Circuit Split On A Central Issue Of Consumer Bankruptcy Law

Respondent admits (at 6, 9) that the decision below conflicts with decisions of the Fourth, Sixth, and Seventh Circuits. His efforts to minimize this square and acknowledged split are unavailing.

1. Respondent asserts (at 7, 8) that, because only a "handful of circuits" have addressed the issue, the split is "shallow and immature." That is doubly wrong.

First, since 2001, four federal courts of appeals have considered this question, and all—save one—have determined that §506(d) does not permit a debtor to void a wholly underwater lien securing an allowed claim. A 3-1 split is hardly a "paucity of circuit precedent." Opp. 8. Indeed, this Court routinely resolves bankruptcy controversies involving shallower splits. *See, e.g.*, *Baker Botts, LLP* v. *ASARCO, LLC*, 83 U.S.L.W. 3094 (U.S. Oct. 2, 2014) (No. 14-103) (granting certiorari on a 1-1 split); *Clark* v. *Rameker*, 134 S. Ct. 2242, 2246 (2014) (1-1 split); *Radlax Gateway Hotel, LLC* v. *Amalgamated Bank*, 132 S. Ct. 2065 (2012) (2-1 split). *Dewsnup* itself resolved a mere 1-1 split. 502 U.S. at 414.

Second, this issue has had more than ample time to percolate. Two of the court of appeals decisions have remained good law in their respective circuits for more than a decade. The decisions are thus "entrenched" (Opp. 9)—whether or not they were issued by en banc courts. And it is simply incorrect that "this Court does not have the benefit of any criticism or reactions by any courts of appeals to one another's opinions" (*id.*). In *In re Talbert*, 344 F.3d 555 (6th Cir. 2003), the Sixth Circuit considered the Fourth Circuit's decision in *Ryan* v.

Homecomings Financial Network, 253 F.3d 778 (4th Cir. 2001), as well as lower court decisions reaching the contrary result. Examining what, at that time, was a wider "divi[sion]" among courts, the Sixth Circuit concluded that "[w]e agree with the Fourth Circuit" that "[t]he Supreme Court's reasoning for not permitting 'strip downs' in the Chapter 7 context applies with equal validity to a debtor's attempt to effectuate a Chapter 7 'strip off.'" *Talbert*, 344 F.3d at 558, 560. The Seventh Circuit's recent decision in *Palomar* v. *First American Bank*, 722 F.3d 992 (7th Cir. 2013), likewise discussed both *Talbert* and *Ryan*. *See* 722 F.3d at 994 (noting that the holdings in those cases "are supported ... [by] *Dewsnup*"). And, finally, the Eleventh Circuit itself candidly acknowledged both *Talbert* and *Ryan*, but explained that it disagreed with those courts and would, instead, follow its pre-*Dewsnup* precedent. Pet. App. 14a-15a.[2] In short, this split will not heal itself.

2. In a similar vein, respondent argues (at 9-10) that the Fourth and Sixth Circuit ruled "before the financial-crisis spike in bankruptcy filings" and thus might reconsider if forced to grapple with "truly valueless second liens." That argument is equally weak.

Both courts of appeals held that "'the reasons articulated by the Supreme Court for its holding in *Dewsnup* ... are equally pertinent'" to wholly underwater second mortgages. *Ryan*, 253 F.3d at 783; *see Talbert*, 344 F.3d at 556. *Ryan* reached that conclusion notwithstanding that "in many cases junior lien holders may have little or no opportunity to recover." 253 F.3d

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[2] The issue is also well percolated in the lower courts, and those courts uniformly hold that *Dewsnup*'s reasoning precludes strip-offs in chapter 7 proceedings.

at 783. The likelihood of recovery, the court explained, was of no consequence because junior lienholders are "entitled to their lien position until ... [a] final disposition is had." *Id.*; *see Talbert*, 344 F.3d 561-562 (same).

Even if those decisions did not expressly repudiate respondent's argument that a "truly valueless" lien might yield a different result, the argument makes no sense—either as a matter of economics or statutory interpretation. There is no such thing as a "truly valueless" lien on property capable of appreciating; such a lien always has some option value, however small. Moreover, as a first mortgage is paid down, the equity available to a second lienholder will typically increase. In any event, the same language in the Bankruptcy Code cannot—and does not—prescribe one kind of treatment for junior liens if a senior lien is "slightly" underwater (Opp. 9) and another kind if the senior lien is deeply underwater. Courts "can[not] give the same statutory text different meanings in different cases." *Clark* v. *Martinez*, 543 U.S. 371, 386 (2005).

3. Finally, respondent's assertion (at 8, 9) that this issue arises "rarely" and is not "important" is belied by the facts described in Bank of America's petition (at 19-21)—which respondent nowhere disputes. Many hundreds of motions to strip off junior liens have been filed in bankruptcy courts in the Eleventh Circuit since *McNeal*, with 65 still pending against Bank of America alone. And underwater junior mortgages affect chapter 7 proceedings nationwide. At the end of the second quarter of 2014, by one count, about 2.1 million borrowers had partly or wholly underwater junior mortgages.[3]

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[3] CoreLogic, *Equity Report, Second Quarter 2014* at 5, *available at* http://www.corelogic.com/research/negative-equity/corelogic-q2-2014-equity-report.pdf.

This issue potentially affects them all—as well as all their lenders. There is perhaps no more important unresolved issue in consumer bankruptcy than this one.

II. This Case Is An Ideal Vehicle To Decide The Question Presented

Respondent's attempt (at 19-21) to conjure up vehicle problems is likewise meritless.

As respondent acknowledges (at 20), there are no facts in dispute. That makes this an ideal vehicle for certiorari, since the legal question on which the courts of appeals have divided is cleanly presented. Respondent asserts that Bank of America "bypassed developing or contesting the relevant facts," but fails to explain how facts such as the "original loan-to-value ratio" have any bearing on the legal question. And even if such facts were somehow relevant, it is respondent, as the movant, who had the burden to develop them. Respondent should not be heard to oppose certiorari on the ground that he failed to make an adequate record below.[4]

Nor is it grounds for denying certiorari that Bank of America "admitted" that the Eleventh Circuit panel and lower courts were bound by circuit precedent—while preserving its right to appeal—or that the panel so held (*see* Opp. 20-21). The courts below *were* bound by *McNeal*. It would have been odd indeed if the Bank did not "admit[]" that, or the courts did not say so. And the "discussion of arguments or reasoning" that respondent finds lacking in the decisions below is con-

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[4] Respondent likewise cannot reasonably complain that the appeal was not "fully brief[ed]" (Opp. 20) where *respondent* filed no brief. The Bank both briefed its position that *McNeal* was wrongly decided and moved for initial hearing en banc, which the court of appeals denied. *See* Pet. 11.

tained in *McNeal* and in *Folendore* v. *Small Business Administration*, 862 F.2d 1537 (11th Cir. 1989), the pre-*Dewsnup* decision on which *McNeal* relied. Respondent's position would appear to be that, now that this Court can no longer review *McNeal* itself, it can *never* review this question, since all future Eleventh Circuit panels—like the panel below—will be bound by *McNeal* and will presumably say so. That is plainly wrong.[5]

Finally, to the extent respondent is contending that the Eleventh Circuit has not had the opportunity fully to consider the question presented here, that contention is also wrong. The lender in *McNeal* filed a petition for en banc rehearing, and the Eleventh Circuit considered that petition for two years—during which time many hundreds of lien-strip motions were filed within the circuit, and lower courts repeatedly and unsuccessfully urged the Eleventh Circuit to take action. Pet. 21.[6] Ultimately, in May 2014, the court of appeals denied rehearing in *McNeal*. The court later denied two additional petitions for rehearing—including one by Bank of America—that had been filed while the petition in *McNeal* was pending. Order, *Wilmington Trust, N.A.* v. *Malone*, No. 13-13688 (July 16, 2014);

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[5] "[T]hat a federal court of appeals acts summarily" or "order[s] that its opinion not be published" is "no bar to Supreme Court review." Shapiro et al., *Supreme Court Practice* 82 (10th ed. 2013). This Court regularly reviews such cases. *See, e.g.*, *Octane Fitness, LLC* v. *Icon Health & Fitness, Inc.*, 134 S. Ct. 1749 (2014) (reviewing court of appeals' summary affirmance of district court's ruling); *Ricci* v. *DeStefano*, 557 U.S. 557 (2009) (reviewing court of appeals' one-paragraph decision).

[6] During that period, this Court denied certiorari in *Bank of America, N.A.* v. *Sinkfield*, 134 S. Ct. 1760 (Mar. 31, 2014). Since then, the Eleventh Circuit has denied rehearing on this issue three times. Any prudential concerns that might have led this Court to deny review in *Sinkfield* thus no longer exist.

Order, *Bank of America, N.A.* v. *Bello*, No. 14-10062 (June 17, 2014). Every effort has been made to persuade the Eleventh Circuit to reconsider *McNeal*, and it has refused to do so.

III. THE DECISION BELOW IS WRONG

Respondent's main argument for denying certiorari is that the Eleventh Circuit's decision is correct. As noted, if that were true, it would be a reason to *grant* certiorari, not to deny it. In any event, the Eleventh Circuit's decision is wrong. It cannot be reconciled with *Dewsnup*—as the court of appeals itself all but admitted (*see* Pet. App. 14a). Respondent's contrary arguments fail.

1. Respondent contends (at 11-14) that *Dewsnup*'s reasoning was limited to partially underwater first mortgages, not wholly underwater second mortgages. Respondent is mistaken.

Section 506(d) of the Bankruptcy Code provides that "[t]o the extent that a lien secures a claim against a debtor that is not an allowed secured claim, such lien is void." Against the backdrop of pre-Code law, under which liens passed through bankruptcy unaffected, *Dewsnup* construed the phrase "'allowed secured claim'" "term-by-term to refer to any claim that is, first, allowed, and, second, secured." 502 U.S. at 415; Pet. 7-8. So understood, an "allowed secured claim" is nothing more than a valid claim "secured by a lien with recourse to the underlying collateral." *Id.* *Dewsnup* thus held that liens may be voided under §506(d) only "when[] [the] *claim* secured by the lien ... has not been allowed," never merely because the value of the collateral has decreased. *Id.* at 416 (emphasis added).

Dewsnup did not conclude, as respondent suggests (at 13), that the loan in that case was "secured" for purposes of §506(d) because the collateral still retained some value. The holding in *Dewsnup* was much simpler: For purposes of §506(d), a claim is "secured" if it is "secured by a lien," regardless of the value of the collateral. 502 U.S. at 414-415. The collateral's value is relevant only to the treatment of the creditor's *claim* under §506(a): To the extent that the creditor's claim exceeds the value of the collateral, the deficiency is treated as an unsecured claim. The collateral's value has no effect on the treatment of the creditor's *lien* under §506(d)—regardless of whether the lien is first-, second-, or third-priority, and regardless of the extent to which it is underwater. "[T]he creditor's lien," consistent with more than a century of bankruptcy principle and practice, "stays with the real property until the foreclosure." *Dewsnup*, 502 U.S. at 417.

2. Respondent contends (at 18-19) that that basic principle does not apply to second mortgages. But *Dewsnup* allows no such distinction. Rather, it explains that "no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." 502 U.S. at 418-419. Respondent adduces no evidence of contrary pre-Code practice for junior liens. Nor could he, because the principle identified in *Dewsnup* governs the treatment of security interests in general and is rooted in constitutional concerns. *See id.* at 418-419; *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 594 (1935). A lienholder's rights—to be paid in full or to take whatever collateral is available—are the same regardless of the lien's priority.

3. Respondent's "policy" arguments fare no better. *Dewsnup*'s "primary rationale" was not "prevent-

ing windfalls to debtors" (Opp. 13). It was the long-established principle that liens ride through bankruptcy and the conclusion that the Code did not alter lienholders' rights in that respect.

In any event, *Dewsnup's* observation that lien-stripping results in a "windfall" to the debtor if the property later appreciates in value applies equally to junior liens. To be sure, such appreciation will benefit an underwater senior lienholder first, but that misses the point. Stripping a lien down to the value of its collateral deprives the lienholder of the benefit of his bargain—that is, the right to benefit from any subsequent increase in value, which "rightly accrues to the benefit of the [secured] creditor," not the debtor or unsecured creditors. *Dewsnup*, 502 U.S. at 417.

Similarly, respondent observes (at 17) that junior lienholders "negotiated for their position subordinate to senior lienholders." It is indeed the case that junior lienholders are junior to senior lienholders. But that truism hardly answers the question whether junior lienholders' interests should be "subordinate" to the interests of unsecured creditors and the debtor. And *Dewsnup* makes clear that junior lienholders are entitled to the benefit of their bargain in that regard.

Finally, respondent argues (at 14-16) that stripping off junior liens would have a salutary effect on the housing market because it would prevent junior lienholders from exercising their right to object to a short sale. This argument fails on multiple levels. As an initial matter, lien-stripping in bankruptcy would not solve the alleged problem. A short sale is a way of modifying a borrower's debt *outside* bankruptcy. In chapter 7, the debtor may surrender the property, in which case it is sold, the creditors recover what they

can, and the debtor's remaining debt is discharged. *See* 11 U.S.C. §§704(a)(1), 725, 727(b). It is not necessary to strip off junior liens to get to that result; lien-stripping is meaningful only if the debtor keeps the property.

More fundamentally, however admirable it may be to "promot[e] consensual resolutions as alternatives to foreclosure" (Opp. 16), neither the Bankruptcy Code nor this Court's precedent permits stripping off junior liens to achieve that aim.

CONCLUSION

The petition for a writ of certiorari in *Bank of America, N.A.* v. *Caulkett*, No. 13-1421, should be granted and this petition held pending that case's disposition. In the alternative, the petition in this case should be granted.

Respectfully submitted.

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